PUBLIC CHARITY STATUS DENIED

SATURDAY, MAY 14, 2011

Code §501(c)(3) organizations usually prefer to be classified as a public charity and not a private foundation. Private foundations are subject to excise taxes and limitations on donor charitable deductions that public charities do not have to deal with, among other disadvantages.

The usual route to public charity status is to meet certain numerical tests that show the foundation has broad funding. Organizations with a limited number of donors will not pass these tests. All is not lost for such organizations. If they can show they are operating for the benefit of one or more other specific public charities, they can qualify as Code §509(a)(3) "supporting organizations" which are treated as public charities.

One requirement (among others) under Code §509(a)(3) is the "organization test" that requires that the organization "is organized and, at all times thereafter, operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more…*specified organizations*" that are public charities (other than by reason of being supporting organizations). Thus the question arises whether a given organization meets this specificity requirement. The Regulations generally require the articles of incorporation to designate each of the specified organizations. Treas.Regs. §1.509(a)-4(d)(2)(i). Further refinements to the requirements are based on the "type" of qualification sought. A Type II organization need not specify by name each publicly supported organization it intends to support if its articles of incorporation "require that it be operated to support or benefit one or more beneficiary organizations which are designated by class or purpose…." Treas.Regs. § 1.509(a)-4(d)(2)(i)(b).

A recent case tested the limits of these identification and specificity requirements. The organization at issue identified the organizations it intended to support as organizations "which support, promote and/or perform public health and/or Christian objectives, including but not limited to Christian evangelism, edification and stewardship."

The IRS argued that this identification did not meet the Type II specificity requirements. It interpreted the "designation by class or purpose" allowance as still requiring that the

identification be specific enough so that the class of beneficiary organizations is "readily identifiable." The taxpayer challenged this gloss on the regulation, but the appellate court determined that the IRS' interpretation of its regulation was not plainly erroneous or inconsistent and thus would be respected.

The organization's description of the organizations it would support was found to be too broad to meet this "readily identifiable" standard. The appellate court noted that there were no geographic limits imposed, nor a limit to a certain type of organization such as a church or seminary.

Note that it is not the number of organizations that are specified that is important – instead, it is whether someone can use the description to actually identify the subject organizations. For example, the IRS and the court noted with approval the description used in Rev.Rul. 81-43. The organization in that ruling described the organizations it will support as "charitable organizations located in the Z area that are exempt under section 501(c)(3) of the Code and are public charities described in section 509(a)(1) or 509(a)(2)." Thus, this description passes muster because even though it may identify a large number of organizations, it is a precise enough standard that the organizations identified can be precisely determined.

Organizations that are not naming their supported public charities by name should take a clue from this case and undertake to include geographic limits and/or identification of the type of organization that will be supported.

Polm Family Foundation v. U.S., 107 AFTR2d Para. 2011-804 (CA DC 5/6/2011)

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